LAW REFORM
COMMISSION
OF
NOVA SCOTIA

Privity of Contract (Third Party Rights)

Final Report - August 2004

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Privity of Contract (Third Party Rights)

Law Reform Commission of Nova Scotia
September, 2004

The Law Reform Commission of Nova Scotia was established in 1991 by the Government of Nova Scotia under an *Act* to *Establish an Independent Law Reform Commission.*

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Law Reform Commission of Nova Scotia

To: The Honourable Michael G. Baker, Q.C.
Minister of Justice and Attorney General

In accordance with section 12(3) of the *Law Reform Commission Act*, we are pleased to present the Commission's Final Report, ***Privity of Contract (Third Party Rights).***

Keith R. Evans
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SUMMARY

The concept of privity provides that only a party to a contract may sue or be sued under it. The concept has two parts. First, only a party to a contract may enforce its terms. Second, a contract cannot impose obligations on a person who is not a party to the contract. The first part of the concept can lead to inconvenience or hardship with respect to those contracts, sometimes known as third party beneficiary agreements, which seek to provide a benefit to a person who is not a party to the contract. A benefit could involve the receipt of something, such as a payment of money, or it could mean a right to avoid or lessen the effect of something, such as a limitation on liability. The range of possible third party beneficiary agreements is quite wide. They could be especially relevant in the context of family gifts, small business transactions, banking arrangements, and employment situations. Regardless of the benefit involved, the third party meant to benefit can obtain no rights under such a contract and will therefore not be able to enforce it.

The Commission is of the view that the current form of the privity rule could lead to situations of inconvenience or hardship, and that the justification for retaining the purity of privity has been undermined by the development of numerous exceptions. Moreover, rather than exclusively approaching privity as a problem to be fixed, the Commission thinks that changes to the privity rule could be viewed more positively, as an opportunity for forward-thinking change. One such opportunity would be to demonstrate how Nova Scotian laws are progressive, outward-looking, and receptive to the requirements of business. The Commission suggests that relaxing privity requirements, by allowing third party beneficiaries to enforce their rights under a contract, could in part help to prevent contractual inconvenience and hardship but more significantly, would allow Nova Scotian contract law to become more advanced, flexible, and receptive to commercial and social realities.

Recommendations for reform

In this Final Report, the Commission makes the following recommendations for reform of the law pertaining to privity of contract, more particularly as it relates to third party rights in contract:

1. The privity of contract concept should be relaxed by statute, to allow third party beneficiaries to enforce their rights under a contract.

2. Although a written third party beneficiary agreement has advantages over an oral one, a proposed statute should not require third party beneficiary agreements to be in written form.

3. Under the proposed statute, a third party beneficiary should be identified in a contract by name, description, or reference to a class.

4. The proposed statute should allow for third party beneficiaries who are not known or in existence at the time a contract is made.

5. A third party beneficiary agreement should be able to extend both positive advantages and to allow the avoidance of certain negative results.

6. The proposed statute should make no distinction between express and implied third party benefits.

7. As is currently the case, contracting parties should ordinarily be able to vary or rescind their agreement at any time. If, however, they know or ought to know that their decision will cause a loss to the third party beneficiary who is relying on the agreement, they will be liable for that reliance loss, except where the agreement stipulates otherwise.

8. The proposed statute should ordinarily entitle a third party beneficiary to enforce an agreement in his or her own name as it relates to his or her rights under the agreement.

9. A third party beneficiary should not be able to enforce a benefit where the contract's language makes it clear that the parties did not intend their agreement to be enforceable by a third party.

10. In legal proceedings involving a third party beneficiary agreement, any defence should be available that could have been raised in proceedings between the parties.

Privity of Contract (Third Party Rights) Final Report

1. Privity of contract & third party rights

The concept of privity provides that only a party to a contract may sue or be sued under it.[1] The concept has two parts. First, only a party to a contract may enforce its terms. Second, a contract cannot impose obligations on a person who is not a party to the contract.[2] The latter aspect is not seen as problematic. It would not be fair to subject people to contractual obligations, such as having to pay money or to perform work, without their consent. However, the first part of the concept can lead to inconvenience or hardship with respect to those contracts, sometimes known as third party beneficiary agreements, which seek to provide a benefit to a person who is not a party to the contract. A benefit could involve the receipt of something, such as a payment of money, or it could mean a right to avoid or lessen the effect of something, such as a limitation on liability. Regardless of the benefit contemplated, the third party meant to benefit can obtain no rights under such a contract and will therefore not be able to enforce it. This aspect of the privity doctrine has been the subject of considerable study, criticism, and in some jurisdictions, legislative action.

As contracts may relate to much of human activity, the range of possible third party beneficiary agreements is quite wide. It has been suggested, though, that they could be especially relevant in the context of family gifts, small business transactions, banking arrangements, and employment situations.[3] For example, a grandparent could agree by contract to provide money to his or her adult child, with a portion to be forwarded to a grandchild, to defray the costs of attending university. Another instance could involve an employer who contracts with an insurance company, in order to obtain health care benefits for employees. In neither situation would the third party beneficiaries, the university student or the employees, have a right to sue under the relevant contracts. Although a party to a contract will always be entitled to enforce it, he or she may not be available, or may not be willing to devote the time and money required.

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[1] Manitoba Law Reform Commission, *Privity of Contract* (Winnipeg: The Commission, 1993) [hereinafter Manitoba Report] at 1.

[2] *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299 [hereinafter *London Drugs*] at 416.

[3] Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (Toronto: Ministry of the Attorney General, 1987) [hereinafter Ontario Report] at 69.

2. Definitions

This Final Report attempts to present legal information as clearly as possible. As some of the language relates to specific legal concepts, the words used may not be familiar to everyone. This section provides definitions of such words used in this Final Report.

Action	The court proceeding by which a person (the plaintiff) makes a claim for damages.
Agency	A relationship in which one person acts for or on behalf of another person at the other person's request.
Assignment	The act whereby one transfers to another his or her interest in a right or property.
Common law	Law developed over the years by judges making decisions in court.
Consideration	An interest or benefit, such as the payment of money, which one party to a contract receives from the other contracting party.
Covenant	Agreement or promise to do or not to do a particular thing.
Privity of contract	Legal concept providing that only a party to a contract may sue or be sued under that contract.
Rescind	To revoke a contract, thereby releasing the parties from further obligations to each other and restoring them to the positions they would have occupied if the contract had never been made.
Subrogation	The substitution of one person for another with respect to a claim or right against a third person.
Trust	A trust is an entity that holds assets for the benefit of certain persons. The person with responsibility for the assets is the trustee. The person for whose benefit the trust operates is the beneficiary.

3. Development of privity & certain exceptions

Privity is not an ancient concept. It arose during the mid-nineteenth century and has been attributed to the view of that era that contracts are bargains. As the price for entering into a bargain, each party must make binding promises. Only those who make promises which form part of a valid contract will be able to enforce any reciprocal promises under that contract.[4]

The common law[5]developed a number of means for avoiding the strict application of privity. In some contexts, courts have applied already existing legal concepts to prevent the otherwise harsh consequences of privity. For example, in some cases, the courts have held that a contract which purported to benefit a third person created a trust for that person's benefit. A trust is an entity that holds assets for the benefit of certain persons. The person with responsibility for the assets is the trustee. The person for whose benefit the trust operates is the beneficiary. This technique, however, has fallen into disuse, given the courts' insistence on sufficiently express language for creation of a trust. There is also an important conceptual distinction between a trust and a contract. Once put into effect, a trust cannot be revoked without the beneficiary's consent. By contrast, contracting parties are free to alter or terminate an agreement they have made.[6] A third party beneficiary agreement might also be considered a type of agency contract. Agency is a relationship in which one person acts for or on behalf of another person at the other person's request.[7] As with a trust, though, the contractual language will have to be specific enough to show that the parties had intended to create an agency. A party to a contract will also be entitled to assign his or her rights to a third party. Assignment is the act whereby one transfers to another his or her interest in a right or property.[8] As a result, the common law will allow someone to do indirectly what he or she cannot do directly.[9] Assignment does not, however, apply to all types of contracts. Contracts involving personal services may not be assigned.[10] In relation to the use of assignment in this context, one commentator has suggested, "it

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[4] S.M. Waddams, *The Law of Contracts*, 4th ed. (Toronto: Canada Law Book, 1999) at 193.

[5] The common law is law developed over the years by judges making decisions in court.

[6] Manitoba Report, note 1, above, at 7.

[7] J. S. Lynton, *Ballentine's Legal Dictionary and Thesaurus* (Albany, N.Y.: Delmar Publishers 1995) at 25.

[8] J.A. Yogis, *Canadian Law Dictionary*, 4th ed. (Hauppauge, N.Y.: Barron's, 1998) at 24.

[9] Ontario Report, note 3, above, at 51-53.

[10] Manitoba Report, note 1, above, at 10.

is pure formalism unworthy of a mature legal system to permit A and B to achieve this result indirectly (by assignment) but to deny effect to a direct attempt to do the same thing."[11]

Exceptions to the privity rule have also developed in relation to certain types of contracts. For example, in a contract for the sale and purchase of land, two parties can agree that a covenant[12] will "run" with the land and thereby bind future purchasers of the property.[13] In mortgage agreements, a standard clause requires the insurer of the mortgaged property, in the event of loss, to pay the mortgagee to the extent of the mortgagor's indebtedness. Courts have recognized the mortgagee's right to enforce this clause. The clause has been treated as a collateral contract, a distinct and separate contract between the mortgagee and the insurer, in order to protect the mortgagee's interest in the mortgaged property.[14] Extending principles of agency, courts have also allowed third parties, such as stevedores, to benefit from limitation of liability clauses in certain contracts of carriage made between a shipper of goods and the carrier.[15]

Provincial legislation also contains other exceptions to the privity doctrine. For example, a bill of lading serves as both evidence of a contract of carriage and a document of title to the goods being carried. The bill of lading initially involves the seller of the goods (consignor) and the carrier. The bill of lading will ultimately be endorsed to a third party, the buyer of the goods (consignee). To facilitate the carriage of goods, under s. 2 of the Nova Scotia *Bills of Lading Act*,[16] a consignee is to receive all rights of action as if the bill of lading had been made out to him or her. Under the Nova Scotia *Insurance Act*,[17] at s. 133, any person who has a claim against someone insured under a motor vehicle liability policy, on recovering judgement against the insured, may have the insurance money payable under the contract applied towards satisfaction of his or her judgement, even though the claimant is not a party to the contract. Another example under the same statute involves life insurance. Section 192 allows the insured to designate a beneficiary. The beneficiary, though not a party to the contracted insurance, is entitled under s. 197 to enforce the payment of money due to him or her under the insurance contract. Furthermore, the *Consumer Protection Act* provides that where an

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[11] Waddams, *The Law of Contracts*, note 4, above, at 194.

[12] A covenant is an agreement or promise to do or not to do a particular thing.

[13] The Law Commission (England & Wales), *Privity of Contract: Contracts for the Benefit of Third Parties* (London: HMSO, 1996) [hereinafter Law Commission Report] at 10-11.

[14] Manitoba Report, note 1, above, at 14.

[15] Note 1, above, at 18-20.

[16] R.S.N.S. 1989, c. 38.

[17] R.S.N.S. 1989, c. 231.

express warranty forms part of an automobile sale or lease contract, each subsequent purchaser or lessee of the automobile has the same rights and remedies under the express warranty as if the subsequent purchaser or lessee had been a party to the original sale or lease contract.[18]

Despite the existence of important exceptions, the privity rule still applies in general to prevent third parties from enforcing contracts under which they are meant to receive benefits.[19] In *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*,[20] the Supreme Court of Canada subjected the privity rule to a detailed review, but did not discard it. London Drugs ("L") had delivered a transformer to Kuehne & Nagel ("K&N") for storage further to the terms of a standard form contract. The contract included a limitation of liability clause restricting the "warehouseman's liability" on any one package to $40. K&N's employees negligently damaged the transformer, causing more than $30,000 in damages. L sued K&N, as well as its employees, for breach of contract and negligence. One issue before the Court was whether the employees could benefit from the limitation of liability clause in the contract between L and K&N. Speaking for the majority of the Court, Iacobucci J. suggested that the privity rule should be limited or modified, given "commercial reality and common sense."[21] He was reluctant, however, to eliminate the rule entirely, acknowledging that major reforms to the common law must come from the legislature.[22] He went on to explain that courts have both a power and a duty to make "incremental changes" to the common law to ensure "that it reflects the emerging needs and values of our society."[23] Iacobucci J. pointed out in part that to strictly uphold the privity rule in this context would allow L to escape the limitation of liability clause to which it had expressly consented. He set out two criteria for extension of the liability clause's application, both of which he found were satisfied in the particular situation: [24]

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[18] R.S.N.S. 1989, c. 92, s. 28A.

[19] In *Greenwood Shopping Plaza Ltd.* v. *Beattie*, [1980] 2 S.C.R. 228, McIntyre J. stated at 238: "There have been many attempts to break out of the rigid mould imposed by the concept of privity and some statutory relief has been provided in special cases but the concept remains one of general application."

[20] *London Drugs*, note 2, above.

[21] Note 2, above, at 415.

[22] Note 2, above, at 436-437.

[23] Note 2, above, at 438.

[24] Note 2, above, at 448. LaForest J., who would have decided the case in K & N's favour on another ground, wrote a separate opinion, in which at 315 he referred to privity as a "pestilential nuisance."

1. *The limitation of liability clause must, either expressly or impliedly, extend its benefit to the employees (or employee) seeking to rely on it.*

2. *the employee(s) seeking the benefit of the limitation of liability clause must have been acting in the course of their employment and performing the very services provided for in the contract between their employer and the customer (plaintiff) when the loss occurred.*

Although *London Drugs* resulted in greater clarity involving an exception to the privity rule, the rule in general remained intact, with the Supreme Court of Canada having declined an opportunity to sweep it aside in its entirety. Abolishing the rule, the Court acknowledged, was a job for the legislature.

The Supreme Court took a similar approach in a more recent case, *Fraser River Pile & Dredge Ltd.* v. *Can-Dive Services Ltd.*[25] This case arose out of the sinking of a chartered barge. Insurers for the barge's owner paid for the loss and then sought to recover from the charterer what they had paid to the owner. The insurers entered into a written subrogation[26] agreement with the owner, whereby the owner contractually agreed to sue the charterer on the insurer's behalf. However, the insurance contract contained a waiver of subrogation clause, whereby the insurers had waived any right to take subrogated action against a number of parties, including a charterer of the barge. The charterer argued that as a third party beneficiary, it should be able to rely upon the benefit of the waiver of subrogation clause.

The Court reviewed the decision in *London Drugs* and chose to follow its approach. The Court acknowledged that the test articulated in *London Drugs* depended upon the particular facts of that case. Nonetheless, the Court held that it could adapt the *London Drugs* test into a more general form, which could then be applied to the scenario in *Fraser River*. The Court considered this to be a way of "extending the principled approach [from *London Drugs*] to establishing a new exception to the doctrine of privity of contract relevant to the circumstances." The Court asked:[27]

(a) *Did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision?*

and

[25] [1999] 3 S.C.R. 108.

[26] Subrogation is the substitution of one person for another with respect to a claim or right against a third person: Lynton, note 7, above, at 643.

[27] Note 25, above, at 126.

(b) *Are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?*

In relation to the first question (protection from a subrogated action), the Court concluded there was no doubt that the parties intended to extend the benefit in question to a class of third party beneficiaries including the charterer. The Court rejected the argument that a post-sinking subrogation agreement would have the effect of deleting the third party benefit from the insurance contract. Following the loss of the barge, the Court reasoned, the charterer's potential benefit under the insurance contract "crystallized," thereby becoming an actual, or real, and therefore enforceable, one. The charterer acquired an actual benefit in the form of a defence against a subrogated action by the insurers. Having contracted in favour of the charterer as within the class of potential third party beneficiaries, the owner and the insurers could not unilaterally revoke the charterer's rights once they had developed into an actual benefit. In relation to the second branch of the test, the Court held that the charterer's activities had been those contemplated in the policy under the terms of the waiver of subrogation clause.

As in *London Drugs*, the Court made similar remarks about relaxing the privity of contract rule to acknowledge commercial reality. Nonetheless, the Court acknowledged that privity of contract was an established part of contract law, one which the Court was not prepared to abolish, given "complex repercussions that exceed the ability of the Courts to anticipate and address": "It is by now a well-established principle that Courts will not undertake judicial reform of this magnitude, recognizing instead that the legislature is better placed to appreciate and accommodate the economic and policy issues involved in introducing sweeping legal reforms."[28] On the other hand, the Court suggested "that in appropriate circumstances, Courts must not abdicate their judicial duty to decide on incremental changes to the common law necessary to address the emerging needs and values in society."[29] The Court held that to allow the third party beneficiaries to rely on a waiver of subrogation clause in the context of *Fraser River* represented only an incremental change to the common law, as had been the case in *London Drugs*. Entirely eliminating the privity rule was, however, another matter, for the legislature to decide.

[28] Note 25, above, at 131-132.

[29] Note 25, above, at 132.

4. Prior law reform agency initiatives

A number of Commonwealth law reform bodies have studied the topic of third party rights in contract. In their reports, these bodies have identified several key issues: how to define who should benefit under a third party provision in a contract; how to approach the issue of which contractual defences may be asserted against a third party's claim; and how to deal with changes to a third party beneficiary contract or with its termination. In the United Kingdom, the Law Revision Committee, which preceded the current English Law Commission, recommended changes to the law of privity as long ago as 1937. The Committee suggested, " [e]xperience has shown that the rule is apt on occasion to lead to inconvenience and, in certain cases, to hardship."[30] The current English Commission, which was established in 1965, continued to study the topic over the years and in 1996 published a lengthy report on privity, deemed "a pressing problem for the English law of contract."[31] The English Commission concluded that the privity rule was no longer consistent with commercial reality and caused difficulties in a number of contractual contexts. The Commission proposed the adoption of a detailed statute which would permit and govern third party beneficiary agreements. The report's suggestions were implemented in the *Contracts (Rights of Third Parties) Act 1999*.[32]

The New Zealand Contracts and Commercial Law Reform Committee, which published a report on this topic in 1981, commented generally that "[w]e have looked in vain for a solid basis of policy justifying the frustration of contractual intentions" by the privity rule.[33] That Commission's report was instrumental to the enactment the following year of detailed legislation governing third party beneficiary agreements in New Zealand. In 1993, as part of a review of contract legislation, the New Zealand Law Commission returned to the topic of privity, but concluded, "[n]o serious problems posed by the terms of the Act have yet come to light."[34]

In a 1987 review of contract law, the Ontario Law Reform Commission ("OLRC") devoted a chapter to privity.[35] The OLRC suggested that the doctrine ran counter to "sensible and commercial and

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[30] Great Britain, Law Revision Committee, *Sixth Interim Report (Statute of Frauds and the Doctrine of Consideration)* (London: HMSO, 1937) [hereinafter Law Revision Committee report] at 25.

[31] Law Commission Report, note 13, above, at 3.

[32] U.K., 1999, c. 31.

[33] New Zealand, Contracts and Commercial Law Reform Committee, *Privity of Contract* [Wellington: Dept. of Justice, c. 1981] at 45.

[34] New Zealand Law Commission, *Contract Statutes Review* (Wellington: The Commission, 1993) at 228.

[35] Ontario Report, note 3, above.

personal arrangements made on a daily basis." Given the number of exceptions allowed by the courts, as well as various statutory inroads, the OLRC suggested that "...this area of the law of contracts is in a very unsatisfactory state." More particularly, the OLRC was concerned that "...the exceptions to the doctrine of privity and glosses on it which the courts have developed have no rational basis except to avoid the application of the doctrine...."[36] In terms of reform, the OLRC recommended the adoption of a general enabling provision, which would establish that contracts for the benefit of third parties would not be unenforceable solely for lack of consideration[37] or want of privity. The OLRC was not in favour of a detailed statutory approach. A set of statutory criteria, the OLRC suggested, would not be adequate to take into account the variety of instances in which third party rights might be in issue. The OLRC preferred to allow the courts flexibility as to what form the new law would take.

In 1993, the Manitoba Law Reform Commission published a comprehensive report on privity of contract.[38] Similar to the English Law Commission, the Manitoba Commission proposed the adoption of a detailed statute to govern instances of third party beneficiary agreements. The Manitoba Commission did not consider it appropriate to rely upon the courts to articulate all of the instances in which a third party beneficiary agreement would be enforceable: "...in reforming the law, the Legislature ought not to abdicate its responsibility to provide normative solutions which will produce appropriate results in the great majority of cases."[39]

Neither the OLRC proposals, nor those from the Manitoba Commission, have resulted in legislation. The Law Reform Branch of the New Brunswick Department of Justice suggested that the privity rule's propensity to "cause injustice in some circumstances [was] widely recognized."[40] The Law Reform Branch proposed dealing with the privity rule through legislation, in the form of "a relatively modest amendment that addresse[d] the most glaring deficiency in the existing law while taking only a small step in creating third party rights that are independent of those of the parties."[41] Suggestions by the Law Reform Branch led to amendment of the common law through statute in 1993.

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[36] Note 3, above, at 49-50.

[37] In the contractual context, consideration refers to an interest or benefit, such as the payment of money, which one party to a contract receives from the other contracting party.

[38] Manitoba Report, note 1, above.

[39] Note 1, above, at 57.

[40] New Brunswick, Office of the Attorney General, Law Reform Branch, *Commentary on the "Law Reform Act"* (Fredericton: Office of the Attorney General, 1993) at para. 2.

[41] Note 40, above, at para. 3.

5. Legislative changes outside Nova Scotia

In 1969, the state of Western Australia became the first Commonwealth jurisdiction to legislatively reform the law of privity.[42] It took an abbreviated approach to third party rights; for example, the relevant section contains no definitions. The state of Queensland followed with a 1974 statute which, while similar, differs in a number of important respects from the Western Australian approach.[43] Both the Western Australian and Queensland statutes rely largely on the 1937 proposals of the U.K. Law Revision Committee, which had succinctly suggested how to allow for the enforceability of third party beneficiary agreements:[44]

> *[W]here a contract by its express terms purports to confer a benefit directly on a third party, it shall be enforceable by the third party in his own name subject to any defences that would have been valid between the contracting parties. Unless the contract otherwise provides, it may be cancelled by the mutual consent of the contracting parties at any time before the third party has adopted it expressly or by conduct.*

England recently adopted a much more detailed statute than the Western Australian or Queensland legislation.[45] The English statute shares similarities in scope and detail with a 1982 New Zealand statute.[46] In Canada, New Brunswick is the only common law jurisdiction which has adopted legislation to deal with the privity rule.[47] The New Brunswick statute has been described as taking a middle course between the detailed approach adopted in New Zealand and the type of general provision preferred by the OLRC.[48] Quebec, similar to other civil law jurisdictions, has recognized third party beneficiary agreements for many years.[49] Most U.S. jurisdictions have also abolished or

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[42] Note 1, above, at 30; Western Australia, *Property Law Act* 1969 (no. 32 of 1969), s. 11.

[43] Queensland, *Property Law Act* (no. 76 of 1974), s. 55.

[44] Law Revision Committee report, note 30, above, at 31-32.

[45] Note 32, above.

[46] New Zealand, *Contracts (Privity) Act* 1982.

[47] *Law Reform Act*, S.N.B. 1993, c. L-1.2.

[48] Manitoba Report, note 1, above, at 54.

[49] Note 1, above, at 34-36. Civil law systems are based on a comprehensive code of laws; their origins extend back to Roman law. D.A. Dukelow & B. Nuse, *The Dictionary of Canadian Law* (Scarborough, Ont.: Thomson, 1991) at 162. By contrast, common law systems, which emphasize law developed over the years by judges making decisions in court, share a background in the law of England.

modified the privity rule.[50] Many of these set out a general enabling provision, and little more. For example, the California Civil Code provides at s. 1559 that "[a] contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it."[51]

6. Issues for discussion

a) Should the law be changed?

The Law Reform Commission is not aware of the concept of privity causing significant problems in Nova Scotia. For example, according to information received by the Commission, the issue of enforcing a third party beneficiary agreement does not seem to arise often at the Small Claims Court. There does not seem to be a constituency pressing for change in this area of the law. Nonetheless, the Commission is of the view that the current form of the privity rule could lead to situations of inconvenience or hardship, and that the justification for retaining the purity of privity has been undermined by the development of numerous exceptions. Moreover, rather than exclusively approaching privity as a problem to be fixed, the Commission thinks that changes to the privity rule could be viewed more positively, as an opportunity for forward-thinking change. One such opportunity would be to demonstrate how Nova Scotian laws are progressive, outward-looking, and receptive to the requirements of business. Another opportunity would be to demonstrate Nova Scotia's commitment to harmonization of laws. New Brunswick is currently the only common law jurisdiction in Canada which has legislation allowing third party rights in contracts. Not only is New Brunswick a neighbouring jurisdiction, the only province connected to Nova Scotia by land, but it is also an important trading partner, with a similar-size population and economy. Making Nova Scotia's laws more compatible with those of New Brunswick could facilitate commercial relationships between people in both provinces. In short, the Commission suggests that relaxing privity requirements, by allowing third party beneficiaries to enforce their rights under a contract, could in part help to prevent contractual inconvenience and hardship, but more significantly, would allow Nova Scotian contract law to become more advanced, flexible, and receptive to commercial and social realities.

Having reached the conclusion that third party beneficiary agreements should be enforceable in Nova Scotia, Commission members agree that this is a job for the legislature and not for the courts. Depending on the courts to initiate legal change means waiting for a fortuitous combination of suitable facts and disputing parties willing to expend both time and money in having their matter adjudicated. The popularity of mediation and arbitration in the commercial context lessens the likelihood that certain types of cases will reach the courts. Even if a dispute about the viability of a

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[50] Waddams, *The Law of Contracts*, note 4, above, at 205.

[51] California Civil Code, online: State of California, Legislative Counsel, Official California Legislative Information Homepage, California Law <www.leginfo.ca.gov/calaw.html> (date accessed: 5 August 2004).

third party beneficiary agreement did reach the courts, there is no guarantee that the courts would wish to comment on privity in general. Perhaps only another exception to the privity concept would result, as took place in *London Drugs*[52] and in *Fraser River*,[53] thereby leading to more complicated laws. It should also not be overlooked that in *London Drugs* and in *Fraser River*, both fairly recent decisions, the Supreme Court of Canada had an opportunity to sweep the privity rule aside entirely, but did not do so. In both instances, the Supreme Court indicated that abolishing the rule was a job for the legislature. Other courts might take their cue from the Supreme Court's reluctance to dispose of the privity rule. The Commission takes the position that a quicker and more certain way of establishing the rights of third party beneficiaries would be by way of statute. That approach would be consistent with recent Supreme Court of Canada statements about privity of contract. The Commission therefore suggests that the privity of contract concept should be relaxed by statute, to allow third party beneficiaries to enforce their rights under a contract.

The Commission recommends:

- The privity of contract concept should be relaxed by statute, to allow third party beneficiaries to enforce their rights under a contract.

b) Must a third party beneficiary agreement be in writing?

With certain exceptions, such as separation agreements, which must be in writing, contracts may be made orally or in written form. In some contexts, as in the case of agreements between family members, parties may prefer the informality of an oral contract. However, if a dispute arises over the terms of a contract, it is generally easier to prove the parties' intentions when written, rather than oral, terms are involved. The Queensland and New Zealand statutes expressly mention the form of a contract.[54] Those statutes allow a third party beneficiary agreement to be oral, written, or a combination. The Commission is of the view there are advantages for a written third party beneficiary agreement over an oral one. Nonetheless, the Commission does not think that a proposed statute should require third party beneficiary agreements to be in written form.

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[52] Note 2, above.

[53] Note 25, above.

[54] Queensland statute, note 43, above, s. 55(6); New Zealand statute, note 46, above, s. 2.

The Commission recommends:

- Although a written third party beneficiary agreement has advantages over an oral one, a proposed statute should not require third party beneficiary agreements to be in written form.

c) Identification of a third party beneficiary

For a third party beneficiary agreement to be workable, there must be some means contained within the contract whereby the beneficiary can be identified, so that he or she could step forward to claim a benefit. A means of identification also narrows the range of people who could possibly claim a benefit under the contract. Otherwise, beneficiaries not contemplated by the contracting parties could demand benefits. For instance, the New Brunswick statute requires a third party beneficiary to be a person "identified by or under the contract as being intended to receive some performance or forbearance under it." [55] *Manderville* v. *Goodfellow's Trucking Ltd.*,[56] one of the few reported decisions to consider the New Brunswick provision in any detail, involved claims by independent truckers against Goodfellow's ("G"), a trucking contractor. G had obtained a hauling contract from the New Brunswick government. G then subcontracted the hauling to a number of independent truckers at a lower rate. The independent truckers had not been named in the contract between G and the New Brunswick government. Nonetheless, the independents argued that they qualified as third party beneficiaries. Their claim was successful at trial, but was dismissed on appeal. The New Brunswick Court of Appeal noted that G was not required under its contract to hire independent truckers, nor did the contract impose any restrictions on G's use of its own trucks. It was only by virtue of subsequent, independent contracts that the independents became entitled to anything in relation to the hauling work. The independents had therefore not been intended by G and the New Brunswick government to receive a benefit under the original hauling contract.[57]

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[55] New Brunswick statute, note 47, above, s. 4(1).

[56] (1999), 210 N.B.R. (2d) 145 (N.B.C.A.).

[57] See also *D.L.B.* v. *New Brunswick (Attorney General)*, [1998] N.B.J. No. 458 (N.B.Q.B.), online: QL (NBJ), in which D.L.B., an applicant for compensation available to victims of sexual abuse at a government-run institution, argued unsuccessfully that under New Brunswick legislation, he should be considered a third party beneficiary to a financial arrangement between another claimant and the Government. D.L.B. had not been identified in the financial arrangement, described as a "contract" by the court for the sake of argument, as being intended to receive some type of performance under it.

It is not clear whether a third party beneficiary in New Brunswick must be mentioned by name in a contract, or whether being part of a more general group will be sufficient. The court in *Manderville* concluded that it did not need to decide "whether generic identification of a party is sufficient to trigger" the use of the third party beneficiary provision.[58] A wider approach would seem to prevail, for example, in New Zealand, where the statute refers to a non-contracting person, "designated by name, description, or reference to a class."[59]

The Commission is of the view there should be some type of identification requirement in a third party beneficiary statute. Identifying a third party beneficiary by name might be satisfactory, but in the interest of a more inclusive approach, the Commission does not wish to make this the only criterion. There are possible scenarios in which the contracting parties may know details such as the occupations or activities of contemplated third party beneficiaries, but may not be aware of their names. For this reason, the Commission prefers the approach in the New Zealand statute, whereby a third party beneficiary must be designated in a contract by name, description, or reference to a class. Since for some people the term "designated" may signal a requirement to specify a beneficiary in writing, the Commission, consistent with an earlier suggestion (at part 6b) not to exclude oral contracts, prefers the more general term, "identified." The Commission therefore suggests that under the proposed statute, a third party beneficiary should be identified in a contract by name, description, or reference to a class.

The Commission recommends:

- Under the proposed statute, a third party beneficiary should be identified in a contract by name, description, or reference to a class.

d) Must a third party beneficiary be known or in existence when a contract is made?

By identifying a "beneficiary" in part as a person who "may not have been identified or in existence at the time when the promise was given," the Queensland statute does not require the beneficiary to be known when the relevant contract is created.[60] The English and New Zealand statutes also

[58] Note 56, above, at 150.

[59] New Zealand statute, note 46, above, s. 4.

[60] Queensland statute, note 43, above, s. 55(6).

expressly state that a beneficiary need not be in existence when the parties enter into the contract.[61] The Commission does not think that a third party beneficiary need be known or in existence at the time a contract is made. Examples can be imagined, as in the contexts of family relations or business, where the contracting parties may wish to put into place a set of obligations, but are not yet able to identify a beneficiary of those obligations. It may be that very scenario which makes a third party beneficiary agreement attractive, as contracting parties are able to immediately put into place promises for the advantage of, for instance, an unborn child or yet to be incorporated business. The Commission therefore suggests that the proposed statute should allow for third party beneficiaries who are not known or in existence at the time a contract is made.

The Commission recommends:

- The proposed statute should allow for third party beneficiaries who are not known or in existence at the time a contract is made.

e) Defining the nature of a benefit

Contracting parties may wish to provide a third party beneficiary with something, such as a sum of money. The parties may also wish to allow the beneficiary to avoid something detrimental, such as an immunity from civil liability. An example in this vein is the New Brunswick statute, which refers to receipt of "some performance or forbearance."[62] In New Zealand, the term "benefit" is designed to include any advantage, any immunity, and any limitation or other qualification of obligations or rights applicable to the third party.[63] To help prevent confusion about what might be enjoyed under a third party beneficiary agreement, the Commission is of the view that an applicable agreement should be able to extend both positive advantages and to allow the avoidance of certain negative results.

Another dimension to the issue of a benefit's nature is whether it must be express or could also be implicit. Some third party beneficiary legislation only allows express third party benefits. For instance, the Western Australian statute refers to a contract which "expressly in its terms purports to confer a

[61] English statute, note 32, above, s. 1(3); New Zealand statute, note 46, above, s. 4.

[62] New Brunswick statute, note 47, above, s. 4(1).

[63] New Zealand statute, note 46, above, s. 2.

benefit directly on a person who is not named as a party to the contract."[64] One view on this issue is that, in order to protect contracting parties from unwanted claims, the proposed statute should require third party benefits to be expressly set out. To return to the hauling contract in *Manderville*, imagine that it mentioned the use of subcontractors. Without a clear statutory provision, which required not only an identified beneficiary, but also an express intention for that person to benefit under the contract, the independent truckers could have argued that implicitly, the contractor G entered into the agreement on their behalf. On the other hand, even a requirement for express benefits may not be adequate to ensure that the parties clearly draft their agreement. Although intending to benefit certain people, the parties may not do so clearly enough to satisfy a requirement for express language.

While not in favour of promoting widespread reliance on implied benefits, the Commission acknowledges there are situations in which as a matter of fairness it would be appropriate to uphold an implied third party benefit. This would, however, be a matter for the courts to decide, after having considered the relevant circumstances. The Commission therefore suggests that the proposed statute should make no distinction between express and implied third party benefits.

The Commission recommends:

- A third party beneficiary agreement should be able to extend both positive advantages and to allow the avoidance of certain negative results.
- The proposed statute should make no distinction between express and implied third party benefits.

f) Variation or termination

Although contracting parties may wish to extend an advantage to a third party under their agreement, they may not wish this advantage to be perpetual. As contracting parties are free to enter into an agreement, they are also free to change that agreement or revoke the agreement, if that is the wish of all parties. Certain factors may also arise which prevent the parties from putting their promised advantage into effect. On the other hand, a third party, once he or she knows of a contractual benefit, should ordinarily be entitled to act upon it. Otherwise, the third party aspect of the agreement may prove to be without merit. A third party beneficiary may therefore rely on his or her knowledge of an agreement when making certain decisions or taking certain action. If the promised benefit turns out

[64] Western Australian statute, note 42, s. 11(2).

not to be provided, then the third party may suffer inconvenience or loss because of that reliance. Balance is required between the competing interests of contracting parties and third party benefriciaries.

Third party beneficiary legislation exhibits different approaches to this issue. For instance, in New Brunswick, the parties may amend or terminate their contract at any time. However, where by doing so, they cause loss to a third party beneficiary who has relied on the contract being performed, that person "may recover the loss from any party to the contract who knew or ought to have known that the expenses would be or had been incurred or that the obligation would be or had been undertaken."[65] In New Zealand, the statute allows the contracting parties to vary or discharge a third party benefit if the contract contains an express provision to that effect when the promise of a benefit is made to a third party. Moreover, the beneficiary must be aware of the provision and must not have materially altered his or his position in reliance on the promise before he or she became aware of the provision.[66] The Western Australian legislation provides that unless the contract states otherwise, it may be cancelled or modified by the mutual consent of the contracting parties at any time before the third party beneficiary has adopted it either expressly or by conduct.[67] Implicitly, therefore, once the third party beneficiary has taken steps to accept or rely upon the portions of the contract in his or her favour, then the contracting parties will not be able to cancel or modify the agreement as it relates to the third party's rights without being answerable for losses which the third party thereby incurs. Under the English statute, where a third party has a right to enforce a term of a contract, the parties to the contract ordinarily may not vary or rescind[68] without the third party's consent if: "(a) the third party has communicated his assent to the term to the promisor, (b) the promisor is aware that the third party has relied on the term, or (c) the promisor can reasonably be expected to have foreseen that the third party would rely on the term and the third party has in fact relied on it." However, the above provisions will not apply and the parties will be able to vary or rescind their contract without the third party beneficiary's consent when the contract expressly entitles them to do so.[69]

In the Discussion Paper, the Commission favoured the New Brunswick approach, whereby contracting parties may vary or rescind their agreement at any time, but if by doing so they cause a

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[65] Note 47, above, s. 4(3).

[66] New Zealand statute, note 46, above, s. 6.

[67] Western Australian statute, note 42, above, s. 11(3).

[68] To rescind (noun form is rescission) a contract is to revoke it, thereby releasing the parties from further obligations to each other and restoring them to the positions they would have occupied if the contract had never been made.: Yogis, note 8, above, at 2, 243.

[69] English statute, note 32, above, s. 2(3). At s. 1(7), the statute defines "the promisor" as "the party to the contract against whom the term is enforceable by the third party."

loss for a third party beneficiary, they will be liable if they knew or ought to have known that the third party beneficiary would incur a loss resulting from his or her reliance on the benefit. Upon further reflection, however, the Commission thinks that to adopt unaltered the essence of the New Brunswick provision in this context would tilt the balance too far in the favour of third party beneficiaries. The Commission takes note of the concept of "freedom of contract," whereby contracting parties will ordinarily be permitted to use their own discretion and to make their agreement as they wish.[70] As parties are free to create a third party beneficiary agreement, the Commission also thinks they should equally be free to vary or rescind that agreement without restriction, if that is their wish.

The Commission therefore recommends here a modified version of its Discussion Paper proposal. Although retaining the position that contracting parties should ordinarily be answerable for any reliance loss their decision to vary or rescind an agreement causes for a third party beneficiary, the Commission also agrees that contracting parties should not be liable for a third party's loss where their agreement indicates otherwise. In other words, further to the freedom of contract, contracting parties should be able to stipulate in their agreement that they will not be responsible for any losses suffered by a third party beneficiary who relies on a benefit in the contract. The Commission notes that this position is consistent with its approach, discussed later on in this Final Report at section 6(g), to the issue of a third party beneficiary's ability to enforce an agreement. Accordingly, the Commission recommends that as is currently the case, contracting parties should ordinarily be able to vary or rescind their agreement at any time. If, however, they know or ought to know that their decision will cause a loss to the third party beneficiary who is relying on the agreement, they will be liable for that reliance loss, except where the agreement stipulates otherwise.

The Commission recommends:

- As is currently the case, contracting parties should ordinarily be able to vary or rescind their agreement at any time. If, however, they know or ought to know that their decision will cause a loss to the third party beneficiary who is relying on the agreement, they will be liable for that reliance loss, except where the agreement stipulates otherwise.

g) Enforceability of an agreement by a third party beneficiary

Third party beneficiary legislation shares a common feature, a provision setting out a beneficiary's ability to enforce a promise. This is hardly surprising, as enforceability of third party beneficiary agreements, which is not generally available at common law, is the essential reason for this type of legislation. This would not affect a contracting party's ability to enforce the contract. However, a

[70] Dukelow & Nuse, note 49, above, at 419.

third party beneficiary may not be able to depend on a contracting party suing to uphold the agreement on the beneficiary's behalf.

The English, New Zealand, Queensland and Western Australian statutes make it clear that a beneficiary who wishes to enforce a third party agreement must do so personally. The Queensland legislation, for example, refers to the entitlement of a beneficiary to sue "in the beneficiary's own name."[71] In this way, the law may be signaling that allowing a beneficiary to sue under a contract to which he or she is not a party is an exception to general legal principles and should not be expanded to allow beneficiaries to sell or assign their rights. The Commission thinks that a proposed statute should ordinarily entitle a third party to enforce the benefit he or she is promised under a third party beneficiary agreement. As well, a third party beneficiary should also be required to personally enforce an agreement.

The English, New Brunswick, and New Zealand statutes include provisions relating to another aspect of enforceability, namely the parties' expectation that an agreement will not be enforceable by a beneficiary. The New Brunswick legislation permits a third party beneficiary to enforce some performance or forbearance "unless the contract provides otherwise."[72] In England, similar to the approach in New Zealand, a third party beneficiary will not be able to enforce a benefit "if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party."[73] At first glance, provisions of this type seem to contradict the essence of third party beneficiary legislation. They are, however, consistent with the concept of freedom of contract. It is also not difficult to contemplate scenarios where the parties may sincerely wish to benefit a third party, but if this proves not possible to fulfill, do not believe the third party benefit should be elevated to the status of a right upon which a law suit could be brought. One possible example is from the family context. For instance, imagine that A, an elderly parent, has entered into a home care agreement with his daughter, B. The agreement provides that B will live in the house rent-free, in exchange for cooking, cleaning, and assisting with A's personal care. Also assume that B has a child, C. As an act of generosity, A agreed, as part of the home care contract, to provide C with a small weekly allowance. Although A and B approached seriously the promise to C, they were not of the view that C could sue A if A could no longer make the payments at some future time. The essence of the contract between A and B, the enjoyment by B of rent-free living in exchange for taking care of A, would remain unaffected. Moreover, A and B could regard as distasteful the prospect of A being sued by his grandchild C. If able to take advantage of a provision such as that in effect in New Brunswick, A and B might expressly stipulate that the third party C could not sue to recover the promised benefit.

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[71] Queensland statute, note 43, above, s. 55(3).

[72] New Brunswick statue, note 47, above, s. 4(1).

[73] English statute, note 32, above, s. 1(2).

Contracting parties may also have no intention for their agreement to benefit a third party. They may fear that third party beneficiary legislation, if enacted in Nova Scotia, might enable some stranger, whom they did not intend to benefit, to try to enforce a benefit under their agreement.

To respect the wishes of contracting parties who do not intend to create an enforceable third party benefit, and to protect contracting parties who do not want their agreement to be misinterpreted as providing a third party benefit, the Commission thinks it is appropriate for the proposed statute to address the issue of when a contract would not be enforceable by a third party. The Commission suggests that a third party should not be able to enforce a benefit where the contract's language makes it clear that the parties did not intend their agreement to be enforceable by a third party.

The Commission recommends:

- The proposed statute should ordinarily entitle a third party beneficiary to enforce an agreement in his or her own name as it relates to his or her rights under the agreement.
- A third party beneficiary should not be able to enforce a benefit where the contract's language makes it clear that the parties did not intend their agreement to be enforceable by a third party.

h) Defences

In a typical contract, with the parties making binding promises, each party, depending on the circumstances, may be entitled to rely on a number of defences to justify a refusal to perform. For example, imagine that B has promised to paint A's house for $5,000, with payment to be made upon satisfactory completion of the job. If B does not do the work, but nonetheless demands payment from A, then A could maintain that B's non-performance was a complete defence to B's claim for payment. Similarly, in the context of a third party beneficiary agreement, though a contracting party may agree about the nature of a promise which was made for the advantage of a third party beneficiary, the party may not agree that criteria necessary for the promise to be fulfilled have been satisfied. To return to the painting contract example, assume that the same promises apply, except that A has promised to pay the $5,000 to a third party, C, who is owed money by B. It wouldn't be fair for A to have to pay C, even though B has not done the painting. To ensure that the inclusion of third party beneficiaries in an agreement does not lessen the requirements which otherwise prevail in contract law, third party beneficiary legislation sets out, in different ways, the principle that the same defences which would ordinarily apply between the contracting parties continue to apply. For example, the New Brunswick statute deals with this issue succinctly, providing that in legal proceedings involving a third party beneficiary agreement, "any defence may be raised that could have been raised in proceedings

between the parties."[74] By contrast, the English statute sets out in detailed (and arguably, complicated) fashion relevant defences available to the contracting party who is being sued by a third party beneficiary:[75]

Defences etc. available to promisor.

3. - (1) *Subsections (2) to (5) apply where, in reliance on section 1, proceedings for the enforcement of a term of a contract are brought by a third party.*

(2) The promisor shall have available to him by way of defence or set-off any matter that-

(a) arises from or in connection with the contract and is relevant to the term, and

(b) would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(3) The promisor shall also have available to him by way of defence or set-off any matter if-

(a) an express term of the contract provides for it to be available to him in proceedings brought by the third party, and

(b) it would have been available to him by way of defence or set-off if the proceedings had been brought by the promisee.

(4) The promisor shall also have available to him-

(a) by way of defence or set-off any matter, and

(b) by way of counterclaim any matter not arising from the contract, that would have been available to him by way of defence or set-off or, as the case may be, by way of counterclaim against the third party if the third party had been a party to the contract.

(5) Subsections (2) and (4) are subject to any express term of the contract as to the matters that are not to be available to the promisor by way of defence,

[74] New Brunswick statute, note 47, above, s. 4(2).

[75] English statute, note 32, above, s. 3.

set-off or counterclaim.

(6) Where in any proceedings brought against him a third party seeks in reliance on section 1 to enforce a term of a contract (including, in particular, a term purporting to exclude or limit liability), he may not do so if he could not have done so (whether by reason of any particular circumstances relating to him or otherwise) had he been a party to the contract.

The Commission thinks that if legal proceedings ensue over a third party beneficiary agreement, a contracting party should have available all defences which he or she could have used in the event of legal action between the contracting parties. The Commission is in favour of the simple and succinct approach used in New Brunswick. The Commission therefore recommends that in legal proceedings involving a third party beneficiary agreement, any defence should be available that could have been raised in proceedings between the contracting parties.

The Commission recommends:

- In legal proceedings involving a third party beneficiary agreement, any defence should be available that could have been raised in proceedings between the parties.

7. LIST OF RECOMMENDATIONS

1. The privity of contract concept should be relaxed by statute, to allow third party beneficiaries to enforce their rights under a contract. [pages 11-12]

2. Although a written third party beneficiary agreement has advantages over an oral one, a proposed statute should not require third party beneficiary agreements to be in written form. [pages 12-13]

3. Under the proposed statute, a third party beneficiary should be identified in a contract by name, description, or reference to a class. [pages 13-14]

4. The proposed statute should allow for third party beneficiaries who are not known or in existence at the time a contract is made. [pages 14-15]

5. A third party beneficiary agreement should be able to extend both positive advantages and to allow the avoidance of certain negative results. [pages 15-16]

6. The proposed statute should make no distinction between express and implied third party benefits. [pages 15-16]

7. As is currently the case, contracting parties should ordinarily be able to vary or rescind their agreement at any time. If, however, they know or ought to know that their decision will cause a loss to the third party beneficiary who is relying on the agreement, they will be liable for that reliance loss, except where the agreement stipulates otherwise. [pages 16-18]

8. The proposed statute should ordinarily entitle a third party beneficiary to enforce an agreement in his or her own name as it relates to his or her rights under the agreement. [pages 18-20]

9. A third party beneficiary should not be able to enforce a benefit where the contract's language makes it clear that the parties did not intend their agreement to be enforceable by a third party. [pages 18-20]

10. In legal proceedings involving a third party beneficiary agreement, any defence should be available that could have been raised in proceedings between the parties. [pages 20-22]